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In the Supreme Court of the United States

OCTOBER TERM, 1940

No. —

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

THE CLEVELAND TRUST COMPANY, TRUSTEE OF THE TRUST ESTATE KNOWN AS GARFIELD BUILDING SITE TRUST

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Sixth Circuit entered in the above cause on November 13, 1940.

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 11–19) is reported in 39 B. T. A. 429. The opinion of the United States Circuit Court of Appeals for the Sixth Circuit (R. 111–115) is reported in 115 F. (2d) 481.

JURISDICTION

The judgment of the United States Circuit Court of Appeals was entered November 13, 1940 (R. 111). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the taxpayer is an association taxable as a corporation, under Section 801 of the Revenue Act of 1934, as determined by the Commissioner, or is taxable merely as a pure trust, under Section 161 of the Revenue Act of 1934, as contended by the taxpayer and decided by the court.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations are set forth in the Appendix, *infra,* pp. 16–21.

STATEMENT

The respondent is trustee of a large business building the beneficial interest in which is divided into 535 shares, evidenced by transferable certificates which had been sold at public offering. The central issue is whether the enterprise may be taxed as an association rather than as a pure trust. The Board of Tax Appeals determined that the respondent was an association but the court below reversed. The facts as found in detail by the Board (R. 11–16) are as follows:

Prior to 1923, a 12-story building had been erected on the premises known as 322 Euclid Avenue, Cleveland, Ohio, which had been used by various institutions as banking quarters. As a result of a merger of the Cleveland Trust Company and the Garfield Savings Bank of Cleveland, the Cleveland Trust Company acquired the property by deed dated February 15, 1923. (R. 11.)

After that merger, the Cleveland Trust Company had no business use for the property. The State Banking & Trust Company desired to obtain the use of the premises for its banking quarters. Negotiations between these parties resulted in an agreement that the State Banking & Trust Company would pay to the Cleveland Trust Company the value of the building in cash and that the necessary further financing of its acquisition of the use of the premises would be arranged under what was locally known as land trust certificate financing. This plan was in general use in Cleveland, Ohio, and the vicinity, in financing real estate, as a substitute for the issuance of mortgage bonds in order to avoid double taxation under the then effective Ohio personal property tax law. Pursuant to that plan after payment of the value of the building in cash to the Cleveland Trust Company on November 15, 1924, the premises were leased to the State Banking & Trust Company for 99 years, the lease to be renewable in perpetuity. The lessee also received a 10-year option to buy the property for $550,000. (R. 11–12.)

Under the lease (R. 28–55), which provided for an annual rental of $30,000, the lessee was required to pay taxes, keep up insurance and maintain the building in good repair (R. 12).

Thereafter, and on the same day, the Cleveland Trust Company declared itself trustee of the fee of these premises, subject to the above-mentioned lease (R. 12).

The trust instrument (R. 64–77) provided that the petitioner held the described premises, subject to the lease, in trust, for the use and benefit of all present and future holders of certificates of equitable ownership therein; that the trustee would pay over quarterly to the record holders of the certificates their proportionate shares of rents or other income received by the trustee from the trust estate, after deducting the trustee's compensation and expenses; that the beneficial interests in the trust estate should be divided into 535 shares, evidenced by certificates of equitable ownership in the premises trusteed; that the trustee should keep suitable books of registration of such interests and the certificates representing them; that duplicate certificates should be issued upon proper proof of destruction or loss of such certificates; that no beneficiary should have any legal title to the trust property, real or personal, but only an equitable interest therein; that no beneficiary should have the right to call for a partition of the trust estate during the continu-

ance of the trust; that no transfer by operation of law of the interest of a beneficiary during the continuance of the trust should terminate the trust nor entitle the legal representative of a deceased beneficiary to an accounting or to any action in the courts or otherwise against the trust estate or the trustee, but that the executors, administrators, or assigns of any deceased beneficiary should succeed to the rights and be subject to the liabilities of the decedent; that notwithstanding any transfer by operation of law of any interest of a beneficiary, the trustee should be protected in his payment of distributions under the trust to the personal representative of any deceased beneficiary and that the rights of such a transferee should be enforceable against and binding upon such personal representative and not against the trustee or trust estate; that the compensation of the trustee for its services as such should be $575 annually, to be deducted from the rents collected by it, in addition to which it was authorized to incur necessary expenses in connection with the printing of the trust instrument, the certificates of equitable ownership, and such books and records as were necessary in connection therewith; that the trustee warranted neither the title to the premises nor the validity of the lease and did not guarantee its performance; that the trustee undertook to exercise only ordinary care in collecting and distributing rentals and carrying out and

distributing the proceeds of a sale; that the trustee should have the exclusive right to manage and control the estate as it deemed for the best interests of the beneficiaries, free from all control by the beneficiaries, as fully as though the trustee were the sole legal and equitable owner of the estate, and should not be subject to any obligations to the beneficiaries other than those especially assumed in the trust instrument; that the trustee could make agreements modifying, amending, or supplementing the lease in its sole discretion; that it could likewise settle claims either in contract or tort against it or the proceeds derived from the trust estate; that the trustee should be protected in acting upon any written document believed by it to be genuine and signed by the proper party; that the trustee should be indemnified from the trust estate for any personal liability incurred in the administration of the trust except such as arose from its personal and willful default; that the trustee should be exempt from liability for any act of commission or omission in the execution of the trust, so long as it acted in good faith, nor was it personally liable for such acts by any of its officers or employees though it was not obliged to give bond for the performance of the trust; that it could borrow funds to meet temporary exigencies in connection with the management of the trust estate but could not thereby bind either the trustee or the bene-

ficiaries personally; that the trustee could advise with legal counsel and the trustee should be protected in any bona fide action taken consistent with such advice; that the obligation of the trustee in the payment of money to the certificate holders was limited to the petitioner as trustee; that in the event of default by the lessee and the termination of the lease became necessary or advisable in the opinion of the trustee, notice should be given to the registered holders of certificates, upon which these holders had the right to advise the trustee whether the property should be offered for sale, or whether another lease thereof should be made, if possible; and, in the event of the failure of a majority in interest of the outstanding certificates to express their wishes, or, if the trustee should find, after making reasonable efforts, that it was impractical to comply with such wish of the certificate holders, the trustee should have full authority to sell, lease, manage, operate, or otherwise dispose of the premises, as it might deem advisable for the best interests of the certificate holders; that upon the exercise by the lessee of its option to purchase or upon the sale by the trustee, upon receipt of the purchase price, after deducting all necessary expenses, including reasonable compensation to the trustee for its services in connection with the completion of the sale, and the distribution of the net proceeds to the certificate holders, the trustee should distribute

such proceeds to the record certificate holders, and for successive trustees. (R. 12–14.)

It was contemplated that the annual rental of $30,000 to be received under the lease would be sufficient to yield to the holder of each $1,000 certificate into which the beneficiaries' interest in the estate was divided, an income of 5½% or $55 per year, after the payment of the trustee's fee, and, upon the exercise of the option to purchase by the lessee, the option price of $550,000 would be sufficient to distribute to each certificate holder approximately $1,028 (R. 14).

The certificates of beneficial ownership were delivered to and sold by the Cleveland Trust Company at $1,000 per certificate. The prospectus issued by that company recited that the land had been appraised at $550,000 and the building at $455,000. Each certificate was entitled "Trustee's Certificate of Equitable Interest The Garfield Lot," and recited that its holder was an owner of a $\frac{1}{535}$ of the beneficial interest and ownership in such premises, which were described in detail, and entitled to receive the rents and profits therefrom during the continuance of the trust, as provided in the trust agreement. The certificate further recited that the premises were subject to a 99-year lease, renewable in perpetuity; that the trustee would pay over to the certificate holder his proportionate share of the rents and proceeds from the sale of the trust estate and that the certificate was transferable. (R. 14.)

The certificate holders had no organization among themselves and never held any meetings (R. 14).

The State Banking & Trust Company, lessee, was thereafter merged into the Union Trust Company of Cleveland, which assumed its obligations as such lessee. In March 1933, a conservator was appointed for the Union Trust Company, and about June 15, 1933, the superintendent of banks of the State of Ohio took over possession of the assets of the Union Trust Company for liquidation, that institution having been determined to be insolvent. (R. 14–15.)

There was no default in the lease until after the appointment of the conservator for the Union Trust Company. Upon that default, the taxpayer, about July 6, 1933, retained counsel for the purpose of collecting delinquent rentals and advising the trustee with respect to its rights in the situation occasioned by the closing of the Union Trust Company. The superintendent of banks of Ohio, in charge of the liquidation of that company, commenced an action in the Common Pleas Court of Cuyahoga County, Ohio, to abandon the lease which had been assumed by the Union Trust Company. In that action, the taxpayer asserted that the superintendent of banks had no legal right to abandon the lease. This action was settled on March 15, 1934, by the payment of $75,000 to the taxpayer by the superintendent of banks

of Ohio, as such liquidator, the release by taxpayer of the superintendent of banks from all claims and liabilities because of the lease, and the assignment to Three Twenty-two Euclid, Incorporated, with the consent of the trutsee. (R. 58–63.) This corporation was newly formed by petitioner, all the stock of which was held by a nominee of the petitioner, for the benefit of the trust. Three Twenty-two Euclid, Incorporated, never had any salaried officers or employees. Its officers and directors were officers or employees of the Cleveland Trust Company and its books of account were kept by an officer of the Cleveland Trust Company. This new corporation was organized for the purpose of taking over the leasehold estate and to preserve its continuity until another long-term tenant for the property could be obtained. (R. 15.)

Under lease dated January 25, 1935 (R. 77–88), and later modified as of April 16, 1936 (R. 91–95), Three Twenty-two Euclid, Incorporated, leased the entire premises to Lerner Shops of Ohio, Incorporated, for 20 years. This lease provided for an annual rental of $35,000 for the first 10 years and $40,000 for the last 10 years; with the demolition of the building then on the property and the construction of a new building suitable to the needs of the lessee, to the construction of which the lessee should contribute $25,000. The new building was constructed under a general contract between Three

Twenty-two Euclid, Incorporated, and the George Rutherford Company, at a total cost of approximately $135,000, of which $25,000 was paid by the lessee and the remainder by Three Twenty-two Euclid, Incorporated, partially out of its own funds and the balance financed by the taxpayer. (R. 15–16.)

Prior to the execution of the lease with the Lerner Shops of Ohio, Incorporated, the collection of rents from the two tenants then occupying the premises was made by the Cleveland Trust Company. Expenses incident to the maintenance of those portions of the premises not occupied by the two sublessees were, during that period, paid by the Cleveland Trust Company, and were only such as were necessary to preserve the property pending the finding of a long-term lessee. After the construction and occupancy of the new building, the rent was paid to Three Twenty-two Euclid, Incorporated, and that corporation paid to the taxpayer the rental on the original 99-year lease. Except for the activities detailed, neither the taxpayer nor Three Twenty-two Euclid, Incorporated, engaged in any other material activities during the several years mentioned, including that of 1934, except the collection and distribution of rentals to the certificate holders. (R. 16.)

The taxpayer reported the income received and distributed to the certificate holders during the year 1934 on a fiduciary income tax return and paid

a tax on undistributed income of the trust for that year in the amount of $799.77. During the year 1934, the taxpayer received no income other than the item of $75,000, mentioned above, which was received in settlement on the litigation occurring upon default in the original lease. During that year, the taxpayer distributed to certificate holders the sum of $29,425. (R. 16.)

The Board concluded (R. 16–19) that the taxpayer was an association taxable as a corporation, but the court below reversed (R. 111–115).

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding and deciding that the taxpayer was taxable as a trust under Section 161 of the Revenue Act of 1934, *infra*.

2. In failing to hold and decide that the taxpayer was an association taxable as a corporation.

3. In reversing the order of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

1. The decision of the court below is in conflict with *Title Insurance & Trust Co.* v. *Commissioner,* 100 F. (2d) 482 (C. C. A. 9th), where the court reached the opposite conclusion upon substantially identical facts. There, as here, a bank, as owner of a 12-story office building, had arranged for a 99-year lease and almost simultaneously with the execution of the lease had placed

the fee of the premises in trust. In both cases, provision was made for certificates of beneficial interest (665 in the *Title Insurance & Trust Co.* case and 535 in the instant case). In both cases, the certificates were transferable and continuity of the trust was not to be affected by death of the beneficial owners. Both the trustees and the certificate holders were protected against personal liability. In addition to the primary function of collecting and disbursing the rentals, the trustees in both cases were empowered, in case of default by the lessee, to take appropriate steps for the protection of the certificate holders, including the power to borrow money and execute securities as well as to lease, operate, sell, or otherwise dispose of the trust property.[1]

2. The decision of the court below is in substantial conflict with the decision of this Court in *Swanson* v. *Commissioner,* 296 U. S. 362. The court below, in ruling that the taxpayer was a pure trust rather than an association, stated that (R. 115): "The trust instrument shows no plan to carry on a business in buying, selling, leasing or dealing in real estate." But in the *Swanson* case, where the trust property consisted of only one

[1] The only material difference lies in the fact that here there was actually a default, giving rise to the trustee's exercise of the broad powers of management during the tax year in question, but that difference makes the case at bar even stronger for the Government than the *Title Insurance & Trust Co.* case.

apartment house, this Court pointed out that no other real estate dealings need be shown. It is also pertinent to observe that in the *Swanson* case, as in the instant case, the rents were actually collected for the trustee by an agent.

3. The question here presented is one of general importance. As observed by the court below (R. 112), this type of trust is in general use in Ohio, and it is probably employed to a considerable extent outside of Ohio, as well. It is important to the administration of the revenue acts that the application of the general principles established by such cases as *Morrissey* v. *Commissioner,* 296 U. S. 344, and *Swanson* v. *Commissioner, supra,* to such a frequently recurring *type* of organization as is here presented be authoritatively settled.

We do not have here merely an individual case calling for the application of established principles. In such circumstances, the Government does not normally seek review in this Court and it opposes petitions for certiorari filed by others. But here there is involved a type of organization in wide use, and a misapplication of established principles affecting the administration of the revenue law with respect to a large number of taxpayers is a matter of importance, particularly when two circuit courts of appeals have reached opposite conclusions upon substantially identical sets of facts.

CONCLUSION

Therefore, it is respectfully submitted that this petition for a writ of certiorari should be granted.

FRANCIS BIDDLE,
Solicitor General.

FEBRUARY 1941.